INFORMATION BULLETIN #8

SALES TAX

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SUBJECT: Application of Sales Tax to the Sale, Lease, and Use of Computers and Computer Related Equipment

REFERENCE: IC 6-2.5-4-1

I.   Definitions

    A. Computer Hardware:

       1.   The machinery and equipment which constitutes the physical computer assembly, including but not limited to such items as:
- Central Processing Units
- Card or Tape Punchers
- Electronic Message Scramblers
- Data Storage Devices
- Processors
- Output Units
- Flexowriters
- Card Readers
- Paper Tape Input Machines
- Verifiers
- Card Converters
- Sorters
- Collators
- Printers
- Panels

- Terminals
- Modems

2. The internalized instruction code which controls the basic operations (i.e., arithmetic and logic) of the computer causing it to execute instructions contained in system programs, is an integral part of the computer. It is not normally accessible or modifiable by the user. Such Internal code systems are considered part of the hardware.

B. Computer Software:

A software program is one in which instructions and routines (programs) are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions.

The software may be in the form of:

1. System programs (except for the instruction codes which are considered tangible personal property in paragraph 2 above) – programs that control the hardware itself and allow it to compile, assemble, and process application programs.
2. Application programs – programs that are created to perform business functions or control or monitor processes.
3. Pre-written programs (canned) – programs that are either system programs or application programs and are not written specifically for the user.
4. Custom programs – programs created specifically for the user.

C. Terminal or "On Line" Arrangement:

This is descriptive of any arrangement whereby the lessee or purchaser of a terminal unit or units is connected by telephone lines or other methods to a computer system in such a way that the input and output operations of the terminal machines and equipment are under direct control of the computer.

D. Batch Services Arrangement:

An arrangement whereby a consumer of computer services acquires access to a computer system in a manner which is not facilitated by a direct connection. Whatever data the consumer has for input is supplied to the operator of the computer for translation to a form acceptable by the computer. In such an arrangement, access to the computer can only be accomplished by intervention of the operator.

II.   Sales and Use Tax application

A. The Sale or Lease of Computer Hardware:

The sale or lease of computer hardware is a retail transaction, and as such is subject to tax based on the total purchase price charged, including but not limited to charges for internalized instruction codes which control the basic computer operations, instructional materials and installation charges.

To the extent that computer hardware will be used directly in direct production, its purchase is exempt from tax. The purchaser must show that the computer has an immediate effect on the article being produced as the result of being an essential and integral part of an integrated production process. With respect to computers, this is known as Computer Assisted Manufacturing (CAM). By contrast, computers used for research and development, known as Computer Assisted Design (CAD) do not qualify for exemption.

B. Transactions Involving Computer Software:

As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser.

Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.

Example One: A software retailer that sells prepackaged programs for use with home television games or other personal computer equipment is considered to be a vendor of tangible personal property and is required to collect sales tax on the sales price of such property.

Example Two: A firm develops and sells pre-written application programs which are available to any of the firm's potential customers. The sale of these programs are subject to tax.

C. Terminal and Batch Service Arrangements:

The sale or lease of computer time through the use of a terminal or as a result of a batch service arrangement is a nontaxable service and is not subject to tax if separately billed or charged. However, any charges for computer machines and equipment (i.e., the terminal) remain subject to tax.

D. Taxable Use of Computer, Machines, Equipment and Applied Programs:

Computer machines, equipment and programs purchased or leased exempt from tax on the basis of a "resale" exemption are subject to use tax if they are put to a taxable use at any time subsequent to the exempt purchase. The subsequent sale of tangible personal property which has been leased or rented is subject to sales or use tax.

E. Lease Subject to Tax as a Unitary Transaction:

A company that leases a computer with exempt software programs and does not segregate in its billing the charge for the software lease makes a transaction which is subject to tax on the entire charge.

F. Sale of Miscellaneous Data:

The sale of statistical reports, graphs, diagrams or any other information produced or complied by a computer and sold or reproduced for sale in substantially the same form as it is so produced is considered to be the sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold.

The charge for reports compiled by a computer exclusively from data furnished by the same person for whom the data is prepared is considered to be for a service and is not subject to sales or use tax unless it is part of a unitary transaction which is subject to sales or use tax.

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Kenneth L. Miller
Commissioner